

Message Text

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ACTION ARA-14

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TO SECSTATE WASHDC 6933

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TAGS: EGEN, EFIN, ETRD, AR, ELAB
SUBJECT: ARGENTINA: ECONOMIC PERFORMANCE IN FIRST SEMESTER

1. SUMMARY: ARGENTINA'S ECONOMIC PERFORMANCE IN THE FIRST SEMESTER OF 1978 WAS BY AND LARGE DISAPPOINTING: GDP DROPPED CONSIDERABLY MORE THAN EXPECTED; UNEMPLOYMENT INCREASED; AVERAGE REAL WAGES FOR BLUE COLLAR WORKERS DECLINED; THE TREASURY BUDGET DEFICIT AND EXPANSION OF THE MONEY SUPPLY WAS HIGHER THAN PROJECTED AND INFLATION EXCEEDED THE LEVEL OF THE SAME 1977 PERIOD. ON THE BRIGHTER SIDE THE EXTERNAL SECTOR'S PERFORMANCE CONTINUED STRONG, GENERATING A SUBSTANTIAL BALANCE OF PAYMENTS SURPLUS AND SWELLING RESERVES TO RECORD LEVELS. THERE SHOULD BE SOME IMPROVEMENT IN THE SECOND SEMESTER OF 1978, WITH ECONOMIC ACTIVITY PICKING UP AND, ASSUMING TIGHT MANAGEMENT OF FISCAL AND MONETARY POLICY, INFLATION ABATING. THE GDP GROWTH FOR THE WHOLE YEAR, HOWEVER, WILL PROBABLY BE NEGATIVE. END SUMMARY.

2. NATIONAL ACCOUNTS:
ECONOMIC ACTIVITY DURING THE FIRST SEMSTER WAS CONSIDERABLY LOWER THAN EXPECTED: GDP WAS DOWN 5.1 PERCENT; INDUSTRIAL PRODUCT DOWN 10.1 PERCENT; GROSS
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FIXED INVESTMENT DOWN 15.7 PERCENT; AND CONSUMPTION DOWN 2.0 PERCENT. ALTHOUGH PRODUCTION IS EXPECTED TO PICK UP IN THE SECOND SEMESTER, THE GROWTH BASIS OF COMPARISON WILL INCLUDE THE PARTICULARLY GOOD THIRD QUARTER OF 1977. AS A RESULT, GDP GROWTH WILL NOT BECOME POSITIVE UNTIL THE FOURTH QUARTER OF 1978 AND THE OVERALL GDP CHANGE FOR 1978 WILL PROBABLY BE

NEGATIVE -- PERHAPS DOWN 2 PERCENT.

3. UNEMPLOYMENT AND REAL WAGES:

(A) AS EXPECTED, THE LATEST INDEC EMPLOYMENT SURVEY FOR THE GREATER BUENOS AIRES AREA SHOWED THAT UNEMPLOYMENT INCREASED FROM 2.2 PERCENT IN OCTOBER 1977 TO 3.9 PERCENT IN MAY 1978 -- STILL A VERY LOW LEVEL CONSIDERING THE EXTENT OF THE DOWNTURN IN ECONOMIC ACTIVITY. INDEC DID NOT UNDERTAKE UNEMPLOYMENT SURVEYS IN OTHER MAJOR ARGENTINE CITIES, REPORTEDLY BECAUSE SO MANY INDEC STATISTICIANS HAVE LEFT FOR BETTER PAYING JOBS IN PRIVATE INDUSTRY.

(B) A WAGE SURVEY PREPARED BY THE CHRISTIAN ASSOCIATION OF BUSINESS EXECUTIVES (ACDE) INDICATES THAT THE AVERAGE REAL WAGES FOR A NORMAL WORK DA OF BLUE COLLAR WORKERS AT THE END OF JUNE 1978 WERE 4.8 PERCENT BELOW THE LEVEL AT YEAR-END 1977. THE DECLINE IN TAKE HOME PAY WAS SOMEWHAT LARGER BECAUSE THE AVERAGE NUMBER OF HOURS WORKED DECREASED FROM 184 HOURS/MONTH IN THE LAST QUARTER OF 1977 TO 175/MONTH IN THE SECOND QUARTER OF 1978. THE SURVEY ALSO SHOWED THAT THE AVERAGE REAL WAGE OF BLUE COLLAR WORKERS INCLUDED IN THE SAMPLE WAS 196 PERCENT HIGHER THAN THE CONTRACT WAGE (THE MINIMUM BASE WAGE ESTABLISHED BY THE GOVERNMENT FOR A PARTICULAR ACTIVITY). THE DIFFERENCE BETWEEN THE CONTRACT

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WAGE AND THE AVERAGE REAL WAGE HAS BEEN GROWING, THUS CORROBORATING OTHER SIGNS THAT THE CONTRACT WAGE ADJUSTED FOR INFLATION -- A STATISTIC COMPILED BY INDEC AND OFTEN USED BY CRITICS OF THE GOVERNMENT -- IS A POOR INDICATOR OF REAL WAGE TRENDS.

4. FISCAL AND MONTETARY PERFORMANCE:

(A) ACCORDING TO PRELIMINARY ESTIMATES, THE TREASURY DEFICIT FOR THE FIRST SEMSTER WAS RUNNING AT AN ANNUAL RATE OF 3.3 PERCENT OF GDP (9.3 PERCENT OF GDP FOR EXPENDITURES AND 6.0 PERCENT OF GDP FOR REVENUE). WHILE EXPENDITURES WERE ROUGHTLY ON TARGET IN REAL TERMS, REVENUE WAS CONSIDERABLY BELOW EXPECTATIONS, PRIMARILY AS A RESULT OF THE LOW LEVEL OF ECONOMIC ACTIVITY. THE DEFICIT WAS FINANCED WITHOUT RECOURSE TO THE CENTRAL BANK, PRIMARILY THROUGH TREASURY BILL AND BOND ISSUES. IT NOW SEEMS CLEAR THAT THE GOVERNMENT WILL BE UNABLE TO MEET ITS TARGET OF KEEPING THE DEFICIT DOWN TO ONE PERCENT OF GDP FOR FISCAL YEAR 1978. IN ORDER TO MEET THAT TARGET, THE TREASURY WOULD HAVE TO HAVE A SURPLUS IN THE SECOND SEMESTER --

AN UNLIKELY EVENTUALITY. WITH MAJOR EFFORT, HOWEVER,
THE GOVERNMENT MAY BE ABLE TO LIMIT THE FULL-YEAR
DEFICIT TO TWO PERCENT OF GDP.

(B) THE MONEY SUPPLY (M2) DURING FIRST FIVE MONTHS
INCREASED AT AN AVERAGE ANNUAL RATE OF AROUND 160
PERCENT -- A SUBSTANTIALLY HIGHER RATE THAN COMPATIBLE
WITH THE 60 PERCENT PRICE RISE ASSUMPTION USED IN THE
PREPARATION OF THE BUDGET. THE EXTERNAL SECTOR AND
THE DEFICIT OF THE MONETARY REGULATION ACCOUNT (A
CENTRAL BANK ACCOUNT WHICH COMPENSATES TIME DEPOSITS
FOR THE AMOUNT IMMOBILIZED BY RESERVE REQUIREMENTS)
WERE PRIMARY SOURCES OF MONETARY EXPANSION. CENTRAL
BANK MEASURES ADOPTED IN MAY (SUCH AS FREE MARKET
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EXCHANGE RATE, PESO DEPOSIT REQUIREMENT FOR VARIOUS
TYPES OF FOREIGN TRADE AND CAPITAL TRANSACTIONS, AND
PREPAYMENT OF FOREIGN DEBT) SHOULD CURB THE IMPACT
OF THE EXTERNAL SECTOR ON THE MONEY SUPPLY. THE
DEFICIT FROM THE MONETARY REGULATION ACCOUNT WILL
DIMINISH AS THE CENTRAL BANK FINDS IT POSSIBLE TO LOWER

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RESERVE REQUIREMENTS BUT THIS WILL TAKE TIME.

5. INFLATION:

THE CONSUMER PRICE INDEX INCREASED 69.5 PERCENT AND THE WHOLESALE PRICE INDEX 57.7 PERCENT DURING THE FIRST SEMESTER -- APPROXIMATELY THE TARGET FOR THE FULL YEAR AND HIGHER THAN THE COMPARABLE 1977 PERIOD. THE RESULTS WERE THEREFORE QUITE DISAPPOINTING, PARTICULARLY SINCE THE STABILIZATION PROGRAM PRODUCED A DOWNTURN IN ECONOMIC ACTIVITY. ASSUMING TIGHTER MANAGEMENT OF FISCAL AND MONETARY POLICY, INFLATION SHOULD ABATE DURING THE SECOND SEMESTER. THE RESULT FOR THE YEAR, HOWEVER, IS LIKELY TO BE TRIPLE DIGIT INFLATION -- STILL THE HIGHEST IN THE WORLD.

6. EXTERNAL SECTOR:

THE PERFORMANCE OF THE EXTERNAL SECTOR CONTINUED TO EXCEED EVEN THE MOST OPTIMISTIC EXPECTATIONS. ARGENTINA HAD A BALANCE OF TRADE SURPLUS OF \$1.3 BILLION IN THE FIRST SEMESTER, WITH EXPORTS OF \$2.9 BILLION (ABOUT THE SAME AS IN 1977) AND IMPORTS OF \$1.6 BILLION (DECREASE OF 13 PERCENT). EXPORTS BENEFITED FROM THE EXCELLENT COARSE GRAIN AND OILSEED HARVEST, HIGHER INTERNATIONAL PRICES FOR AGRICULTURAL COMMODITIES, AND UNCLASSIFIED

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DEPRESSED INTERNAL DEMAND FORCING THE INDUSTRIAL SECTOR TO SEEK MARKETS ABROAD. THE DECLINE IN IMPORTS REFLECTED THE ECONOMIC SLUMP. AS A RESULT OF THE TRADE SURPLUS AND A NET CAPITAL INFLOW, THE CENTRAL BANK'S RESERVES INCREASED BY \$1.6 BILLION DURING THE SEMESTER AND STOOD AT \$5.5 BILLION AT THE END OF JUNE -- THE EQUIVALENT OF AROUND 16 MONTHS OF IMPORTS. THE EVERY SUCCESS OF THE EXTERNAL SECTOR CONTINUED TO THREATEN THE GOVERNMENT'S STABILIZATION PROGRAM AND LED THE CENTRAL BANK TO ADOPT VARIOUS EXCHANGE RATE AND FINANCIAL MEASURES DESIGNED TO DISCOURAGE ANY FURTHER BUILD UP IN FOREIGN EXCHANGE RESERVES DURING THE REMAINDER OF THE YEAR.

7. COMMENT: THE SOMEWHAT DISAPPOINTING RESULTS FOR THE FIRST SEMESTER HAVE GIVEN MARTINEZ DE HOZ'S CRITICS PLENTY OF AMMUNITION WITH WHICH TO ATTACK HIM. BOTH ALVARO ALSO GARAY, MINISTER OF ECONOMY UNDER GUIDO AND FRONDIZI, AND ROGELIO FRIGERIO, EMINENCE GRISE UNDER FRONDIZI, HAVE FOCUSED ON CONTINUED HIGH INFLATION, THE DECLINE IN REAL WAGES, AND WHAT THEY DEEM IS INSUFFICIENT PROGRESS IN REDUCING THE PREPONDERANT ROLE OF THE PUBLIC SECTOR IN THE ECONOMY. ALSOGARAY HAS BEEN RECOMMENDING A "SHOCK" STABILIZATION PROGRAM SIMILAR TO THAT ADOPTED IN CHILE AND HAS REPEATEDLY WARNED THAT MARTINEZ DE HOZ'S "PRAGMATIC-GRADUALIST" APPROACH IS DOOMED TO FAILURE. ROGELIO

FRIGERIO, ON THE OTHER HAND, HAS STRESSED THE NEED TO
STIMULATE INVESTMENT IN THE BASIC SECTORS OF THE
ECONOMY AND HAS OPPOSED VIGOROUSLY MARTINEZ DE HOZ'S
MEASURES TO EXPOSE LOCAL INDUSTRY TO INCREASING COMPETITION
FROM ABROAD. THE PERONISTS NATURALLY EMPHASIZE
THE ADVERSE IMPACT OF THE CURRENT GOVERNMENT'S
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POLICIES ON THE LABOR SECTOR. GOVERNMENT SUPPORTERS HAVE
COUNTERED THESE CRITICISMS BY SAYING THAT THE "SHOCK"
TREATMENT IS UNACCEPTABLE TO THE ARGENTINE PUBLIC
BECAUSE IT WOULD LEAD TO HIGH LEVELS OF UNEMPLOYMENT
AND IN ANY CASE COULD NOT HAVE BEEN IMPLEMENTED WHILE
TERRORISM WAS STILL A MAJOR THREAT TO THE COUNTRY;
EFFORTS TO REDUCE THE SIZE OF THE PUBLIC SECTOR ARE
IN MANY INSTANCES BLOCKED BY THE MILITARY ESTABLISHMENT
WHICH IN EFFECT BENEFITS FROM SUCH STATE ENTERPRISES
AS FABRICACIONES MILITARES; FRIGERIO'S "DEVELOPMENTALIST"
POLICIES WOULD INCREASE INFLATIONARY PRESSURES AND
LEAD TO MORE AND NOT LESS GOVERNMENT; CONTINUED PRO-
TECTION OF LOCAL INDUSTRY WILL PREVENT ARGENTINA
FROM DEVELOPING INTO A STRONG, EFFICIENT ECONOMY; THE
FLAT WAGE STRUCTURE UNDER THE PERON REGIME DISCOURAGED
PRODUCTIVITY; AND NOMINAL WAGE RAISES BY GOVERNMENT
DECREE ARE ILLUSORY BECAUSE THEY LEAD TO FURTHER
INFLATION AND REAL WAGES WILL RISE AS PRODUCTIVITY
INCREASES. DESPITE THESE MORE FREQUENT PUBLIC ATTACKS,
THE CONSENSUS APPEARS TO BE THAT MINISTER OF ECONOMY
MARTINEZ DE HOZ WILL REMAIN IN OFFICE AT LEAST UNTIL
MARCH OF 1979. THE POLITICAL VIABILITY OF HIS
ECONOMIC ORIENTATION WILL NO DOUBT BE INFLUENCED BY
ECONOMIC PERFORMANCE IN THE SECOND SEMESTER OF 1978.
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